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SUBJECT: SLOVAKIA ECONOMIC ROUNDUP - JULY 18, 2006

TENSIONS SURROUNDING ECONOMIC PROGRAM PUT KORUN UNDER PRESSURE

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11. (SBU) The Slovak korun has faced intense weakening pressure over the past two weeks due to investor uncertainties about the future direction of GOS economic policies. Prime Minister Robert Fico and Finance Minister-designate Jan Pociatek have clashed in public about economic and fiscal plans, particularly on taxation and Euro adoption. Pociatek has said the new government was committed to fulfill Maastricht criteria and Euro adoption in 2009, while Fico has been less certain, saying that he would only do what he considers "best for the Slovaks at the particular time." In response to conflicting signals, the korun weakened from SKK/EUR 38.400 to SKK 38.830 since the June 17 election. The slide could have been much deeper, but the Central Bank intervened three times in the past two weeks to halt its decline. According to estimates by currency traders, the Slovak central bank probably spent a massive EUR 3.15 billion (aggregate) in its early July interventions, roughly 25 percent of total reserves. Only about EUR 1 billion is available for further hot money interventions by the Central Bank, however, suggesting that a deeper devaluation of the korun is possible in the near future.

12. (SBU) In order to appease markets, Central Bank Governor Ivan Sramko called for a meeting with Fico and Pociatek last week to ask them to speak with a common, moderate voice on fiscal policy and Euro adoption. Fico apparently left the meeting convinced, assuring the Central Bank that Slovakia will stick to the plan of Euro adoption in 2009. Traders said, however, that Fico is still short on specifics and that they would wait for concrete measures and policies in the new government program, to assess whether Euro adoption is still possible. The government's economic program is due on August 1.

FINANCE MINISTER CALLS FOR FISCAL PRUDENCE

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13. (U) During his first interview after being named to the office, Finance Minister Pociatek said he would direct budget priorities toward lower-income families, but would "at the same time absolutely respect the fiscal criteria required for Euro entry." (Note: The EU requires a fiscal deficit under 3 percent of GDP to qualify for Euro adoption.) Pociatek has said he wants to introduce a lower VAT on food, boost subsidies on mortgages for young families, pay Christmas bonuses to pensioners and sweeten direct payments to farmers, within the limits of the economy. Pociatek's list of priorities is interesting because, while it is philosophically similar to Fico's proposals, each item is distinct from anything that Fico actually proposed on the campaign trail. In further contrast to Fico, Pociatek added that he does not intend to introduce higher tax rates on monopolies and banks, nor re-introduce any tax on dividends. Pociatek called for keeping a flat 19 percent corporate and personal

income tax, but with "adjustments in personal income tax deductibles to benefit the poor."

LABOR MINISTER PROMISES CHANGES IN PENSION SYSTEM, LABOR CODE

14. (U) New Labor, Social Affairs and Family Minister Viera Tomanova said on July 11 that the highest item on her agenda will be "modifying the current model of the pension security system." Tomanova has suggested that she plans to shift more money to the traditional public pay-as-you-go system and less toward the privately funded system adopted by the Dzurinda government. Many younger Slovaks have voiced concern over Tomanova's statements, since the private system promises to be more favorable for them. The new Minister has already rejected the Dzurinda government's draft plan to increase the retirement age to 65.

15. (U) Tomanova also said on July 17 that "modification of the current, unfriendly labor code is a must." She is particularly interested in strengthening the rights of part-time employees and restoring labor union rights. The Minister has not, however, suggested any changes in basic hiring and firing practices - perhaps the greatest point of interest for major employers in Slovakia. She added that she does not see "any space for reduction of payroll taxes at the moment."

Basic Statistics

16. (U) Consumer prices rose 0.1 percent in June 2006, and have risen 4.6 percent over the past 12 months, the Statistics Office reported. The breakdown of data showed no substantial demand-pull pressures in inflation at the moment. In spite of that, analysts expect the central bank to adopt a rate hike of 50 basic points in July (from 4 to 4.5 percent) to rein in potential inflationary pressures and support the korun. According to the Ministry of Labor, Social Affairs and Family, the disposable unemployment

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rate, which refers to those jobless immediately available and seeking works, was 10.36 percent in June (or 10.9 percent if adjusted for seasonal effects). While Bratislava district IV reported unemployment of only 1.94 percent, Rimavska Sobota suffered the highest rate of 28.94 percent.

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